

## International outsourcing as a challenge for the world trade system\*

ELENA SIVACHEVA and KSENIA KAPRALOVA \*\*

ABSTRACT. From the strategic management point of view, the twenty-first century is being widely recognized as the century for outsourcing in the global economy. In the meantime international outsourcing is one of the most dynamic, innovation-driven and complicated processes in modern world. The present paper concentrates on the essence of international outsourcing (tracing its roots in the international division of labour and world economic relations theoretical approaches), reviews its explicit and implicit challenges and finally presents opportunities for regulating international outsourcing. Attention is focused on the following key questions: to what extent does international outsourcing represent a challenge for the world trade system? what contribution does international outsourcing make to economic «strength» in the modern world?

### Introduction

The main objective of this essay is to consider offshore outsourcing as an increasingly important phenomenon of the world economy and to define the challenges implied for the international trade system. We define and explain the main ideas in the context of modern trends in international outsourcing, describing in particular «international outsourcing» in terms of international trade in services, trade in goods and foreign direct investment issues and specifying constraints on international outsourcing measurement. In addition, we examine current trends in outsourcing-based international cooperation, with special emphasis on the structure of the international outsourcing market. Taking into consideration the role of international outsourcing and current trends in the world trade system, we provide an overview of positions of Russia and China in this market. The critical question here is as follows: what contribution does international outsourcing make to economic «strength» in the modern world?

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\*\* *Elena Sivacheva* and *Ksenia Kapralova* are post-graduate students in the International Economics Department of the School of Economics at St. Petersburg State University. This paper was written as part of a Master of Science Degree Program in «International Trading System», implemented by the Department of International Economics, St. Petersburg State University, Russia, in co-operation with the Centre for Trade Policy and Law (CTPL), Ottawa, Canada and with the support of Canadian International Development Agency (CIDA).

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We review the main benefits and challenges implied by international outsourcing for distinct participants, groups of countries and the international economic relations system as a whole. We attempt to trace other opportunities, except cost reduction, and other challenges, except job losses, entailed by international outsourcing and in what way they should be addressed.

Finally, we suggest that the regulation of offshoring relations among global market participants on the international level is one of the critical issues on the trade policy agenda. The paper then investigates the weaknesses and obstacles for a modern offshore regulating system and in what way these should be addressed to improve the feasibility of such a system.

## **The Essence of International Outsourcing, Current Trends and Market Structure**

### *Core definitions and international outsourcing specifics*

Growth, challenge and change are significant aspects of modern international economic relations. In this respect international outsourcing, the focus of this paper, is a prominent example of a more frequently employed business practice, a reflection of globalization processes, and which entails both benefits and challenges for market participants.

Due to the multidimensional aspect of the notion «outsourcing» and the constant evolution of the international outsourcing phenomenon itself, there is no single precise definition of international outsourcing neither in academic (Bhagwati, 2004; Jensen and Kletzer, 2005) and business circles, nor in the context of international economic organizations (World Bank and IMF Working Papers). Nevertheless outsourcing generally refers to the procurement of material inputs or services by a firm from outside the firm, with the outside supplier being foreign in the case of international outsourcing. International outsourcing, primarily concerning international outsourcing of services, is also referred to as offshore outsourcing (or offshoring).

In an attempt to clarify the terminology, four types of «outsourcing» could be suggested, using location and control/ownership as distinguishing criteria<sup>2</sup>:

*Table 1*

**Types of outsourcing**

Shifting intra-firm inputs/ supplies to		Located in home economy	Located abroad
	Non-affiliated firm	Local/domestic/ onshore outsourcing	Offshore outsourcing = offshoring
Affiliated firm	Captive onshore outsourcing	Captive offshore outsourcing = captive offshoring	

<sup>2</sup> *World Trade Report 2005*, Geneva: UNCTAD, 2005, [www.unctad.org](http://www.unctad.org)

*Source:* adopted from UNCTAD World Trade Report (2005).

The paper will in later pages present international outsourcing as a model for business, according to which a company transfers its separate functions or business processes to an outside foreign organization under a long-term agreement.

### **International outsourcing in terms of international economic relations**

It is possible to derive separate definitions for international outsourcing with relation to international trade in service and international trade in goods.

International outsourcing is described as Mode 1 of trade in services of the WTO terminology<sup>3</sup>, involving arm's-length supply of services, with the supplier and buyer remaining in their respective locations.

At the same time the specifics of international manufacturing outsourcing (which is primarily based on long-term cooperation agreements) highlights the boundary between international manufacturing outsourcing and international goods supplied under sub-contracting. In the case of outsourcing all the risks associated with the project are carried by the seller, while with sub-contracting the risks are shared between the outsourcer and the buyer. In general, international manufacturing outsourcing can be defined as a particular case of global export and import operations.

According to Bhagwati (2004), the phenomenon of direct foreign investment is often added indiscriminately to the discussion of outsourcing of services (as when a firm closes its plant in Boston and invests in production in Bombay, or when a firm simply opens up a factory in Nairobi instead of in Nantucket). This confuses the phenomenon of trade in services with foreign direct investment. «But foreign direct investment is not the same as offshore outsourcing, even though sometimes both phenomena are tied together as, for example, when Dell invests in an outsourcing facility for call answering in Bangalore. The two phenomena are both empirically and analytically distinct».<sup>4</sup>

### **Measuring international outsourcing**

The first challenge lies with the essence of international outsourcing, which is a phenomenon that is not only hard to define, but to quantify as well.

<sup>3</sup> This will be addressed further and will take into account the GATS approach to international outsourcing.

<sup>4</sup> Jagdish Bhagwati, Arvind Panagariya and T. N. Srinivasan, «The Muddles Over Outsourcing,» *Journal of Economic Perspectives* 18 (Fall 2004).

A major problem with the definitions above is that they do not accord easily with officially collected economic data. Outsourcing decisions are made at the micro, firm, level, while official data are generally collected at sectoral and national levels. In the case of international outsourcing, current statistical concepts do not allow a link between import statistics and a management decision to substitute a product or service produced internally by an imported one.

International services outsourcing is even harder to measure. Firstly, flows in trade in services recorded in balance of payments statistics are generally not broken down by region and country, which hampers any analysis of the geographic aspects of services offshoring.<sup>5</sup> Moreover, there is no easy correspondence between the services that are being traded and the statistical classifications of the existing service sector. Furthermore, this trade, by its very nature, is hard to measure — no customs officials record the movement of products and keeping track of the associated international financial transactions is difficult.<sup>6</sup> A further difficulty in trade in services statistics is due to the importance of the large internal services transactions of multinational firms. Many of these internal cross-border transactions might not be reported.

Nevertheless, various attempts to construct a full picture based on available data are found in international economic organizations' reports, periodicals and academic papers.

One more current approach to international outsourcing deals with «job export» from countries buying services on an outsourcing basis, its implications and estimations. Concerns from developed countries, particularly the United States, are that offshoring will export jobs to low-cost countries resulting in unemployment and a downward pressure on wages. In poor countries there are high hopes and expectations that international outsourcing will be the engine of growth and job creation. The importance of these conclusions is further discussed in this paper in the section devoted to international outsourcing challenges.

### **International outsourcing market structure**

On the whole, international outsourcing market current development is characterised by the following general trends:

1. The differentiation of outsourced services, further specialisation, on the one hand, and the appearance of complex products/decisions, supplied by world leaders of outsourcing, on the other;
2. An increase in the volume of outsourced services in separate market segments, rise in the value of contracts as well as a greater business scope in total outsourcing;

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<sup>5</sup> *World Trade Report 2005*, Geneva: UNCTAD, 2005, [www.unctad.org](http://www.unctad.org)

<sup>6</sup> *Aaditya Mattoo and Sacha Wunsch-Vincent*, «Pre-empting Protectionism in Services: The WTO and Outsourcing,» World Bank Policy Research Working Paper 3237, March 2004, Washington, United States, <http://ideas.repec.org/p/wbk/wbrwps/3237.html>.

3. The creation of strategic alliances by large companies with small and middle specialised market players on the basis of global outsourcing; and,

4. A turn away from providing outsourcing services only to large customers to clients from small and middle business.

International outsourcing tends to be one of the most dynamic, innovation-driven and complicated processes in the global economy, and criteria for structuring these business relations are needed. Therefore we suggest several options for classifying international collaboration based on outsourcing, which are essential to realise international outsourcing modern developments and trends:

1. First of all, we distinguish between international manufacturing outsourcing and international service outsourcing.

The origins of practical outsourcing as an efficient management tool in manufacturing are traced back to the opposition period of two great managers Henry Ford and Alfred Sloan, heads of the giants of the automobile industry, Ford and General Motors. The struggle of automobile construction leaders was revealed in the 1930s, specifically that no single company was able to succeed by relying only on internal resources. Indeed, American Management Association investigations demonstrated that already in 1997 more than half of industrial companies resorted to outsourcing of at least one component of their production process.<sup>7</sup> Currently Toyota, for instance, only designs, produces and assembles its products, with the majority of spare parts and other components being supplied by external enterprises.<sup>8</sup> According to the WTO, in 1998 only 37% of value for a motor vehicle put on the market in the United States were produced domestically. At the same time 30% of a vehicle's value were outsourced to South Korea for assembly, 7.5 % — to Germany for design, 4 % — to Taiwan and Singapore — for small parts, 2.5 % — to Great Britain for advertising and marketing and 1.5 % — to Ireland and Barbados for data processing.<sup>9</sup>

China has secured its dominant position in international manufacturing outsourcing, primarily due to its low-cost pre-eminence over emerging and other markets. In the present context of economic globalisation, most multinational automobile giants' operations are based on international outsourcing.

Currently some authors suggest that since the beginning of the twenty-first century outsourcing is no longer about purchases of manufactured physical inputs from outside the firm, and refers now to a specific segment of the growing international trade in services.<sup>10</sup> However, the use of the term international outsourcing

<sup>7</sup> D. J. Bryce and M. Useem, «The Impact of Corporate Outsourcing on Company Value,» *European Management Journal* 16:6 (1998): p. 635—643.

<sup>8</sup> B. Anikin and I. Rudaya, *Outsourcing and Outstaffing: High Technologies of Management* (Moscow.: Infra-M, 2006), p. 9.

<sup>9</sup> *Annual Report 1998*, World Trade Organization, Geneva: World Trade Organization (WTO), 1998.

<sup>10</sup> Jagdish Bhagwati, Arvind Panagariya and T. N. Srinivasan, «The Muddles Over Outsourcing,» *Journal of Economic Perspectives* 18 (Fall 2004).

has not been standardized, and international manufacturing outsourcing should not be disregarded.

The growing outsourcing of services in industrial countries is recognized to be simply a reflection of the benefits from the greater division of labor and trade that have been described for manufactured goods since the time of Adam Smith and David Ricardo.<sup>11</sup> Nonetheless, despite international outsourcing of material inputs being still far greater than that of services<sup>12</sup> for a typical industrial economy according to International Monetary Fund data, the current wave of anxiety is largely about services.

2. Further classification breaks down the outsourcing business by subject criteria to:

Information Technology Services Outsourcing (ITO), that roughly amounts to 2/3 of international services outsourcing<sup>13</sup> and Business Process Outsourcing (BPO), comprising nearly 1/3 of international outsourcing in services. Meantime, BPO is currently the most dynamic area of services trade, and accounts for the bulk of the increased trade involving developing countries. On the basis of a consensus analysis by the market research firms Aberdeen Group, Gartner and IDC, the BPO market is projected to grow by 35 to 40 per cent annually till 2010.<sup>14</sup>

Table 2 provides a list of the most common outsourced internationally IT and BPO service activities.

Table 2

### Information Technology and Business Process Outsourcing Services

1. INFORMATION TECHNOLOGY SERVICES (COMPUTER AND RELATED SERVICES)	
Software Development and Implementation Services, Data processing and Database Services, IT Support Services, Application Development & Maintenance, Business Intelligence & Data Warehousing, Content Management, E-procurement and B2B Marketplaces, Enterprise Security, Package Implementation, System Integration, SCM, Enterprise Application Integration, Total Infrastructure Outsourcing, Web Services (Internet Content Preparation, etc.), Web-hosting and Application Service Providers (ASPs)	
2. BUSINESS PROCESS OUTSOURCING	
CUSTOMER INTERACTION SERVICES	Sales Support, Membership Management, Claims, Reservations for Airlines and Hotels, Subscription Renewal, Customer Services Helpline, Handling Credit and Billing Problems, etc. Telemarketing and Marketing Research Services
BACK-OFFICE OPERATIONS	Data entry and handling, Data processing and database Services, Medical Transcription, Payment Services, Financial Processing (financial information and data processing / handling), Human Resource Processing Services, Payroll Services, Warehousing,

<sup>11</sup> Mary Amiti and Shang-Jin Wei, «Demystifying Outsourcing,» *Finance & Development* (December 2004).

<sup>12</sup> International Monetary Fund, [www.imf.org](http://www.imf.org)

<sup>13</sup> D. M. Mikhailov, *Outsourcing: New Approach to Business Organization* (Moscow: Publisher «Chorus», 2006); [www.Cnews.ru](http://www.Cnews.ru), 2004.

<sup>14</sup> «Business Process Offshore Outsourcing: Untapped Opportunities for SMEs,» UNCTAD Paper, 2005.

	Logistics, Inventory, Supply Chain Services, Ticketing, Insurance Claims Adjudication, Mortgage Processing
MORE INDEPENDENT PROFESSIONAL OR BUSINESS SERVICES	Human Resource Services (Hiring, Benefit Planning and Payroll, etc.), Finance & Accounting Services (including Auditing, Book-keeping, Taxation Services, etc.), Marketing Services, Product Design and Development

*Sources:* World Bank compilation based on information obtained from service providers (Internet pages), NASSCOM, and ITC (2000). The list of activities is neither exhaustive nor are the categories mutually exclusive.

An obstacle arises when we attempt to look at the sectoral breakdown of international outsourcing. The sectoral affiliation of a firm might not match the product or service which is outsourced. For example, an automobile company might offshore its accounting services and a bank might offshore its IT services. Such difficulties in the sectoral allocation of offshored activities also affect an assessment of the international outsourcing potential of an economy and is, undoubtedly, a subject for further research.

3. Concerning the geographical structure of the international outsourcing market,<sup>15</sup> from the demand side, according to TPI, a leading adviser on outsourcing, if we consider all new contracts worth more than 40 millions euros, we will find that in 2004 Europe accounted for 49% of the value of these contracts, the United States comprised 42.3%, with Japan representing 1.6% and the rest of the world accounting for 7.1%.<sup>16</sup> A recent survey by Bain & Co (a consultancy firm) found that nearly 82% of large firms in Europe, Asia and North America are currently using the strategy of outsourcing, and 51% are outsourcing offshore.<sup>17</sup>

Standard, low-value activities are continuously outsourced primarily from USA to Asia. At the same time, more complex technological processes are being outsourced from North America and Europe not to particular countries, but to specialized companies (for example, IBM Global Services, Accenture), which further partially outsource the work to countries with smaller labor costs.

The «Big Six» of leading outsourcing providing companies — IBM, Accenture, EDS (Electronic Data System), ACS (Affiliated Computer Services), CDS (Computer Sciences) and Hewlett-Packard — are all American. However, with an increase in the outsourcing market growth in Europe, their market share has shrunk by almost two thirds in 2004, while European outsource-

<sup>15</sup> The phrasing «international outsourcing market» is rather controversial and subject to debate. According to the academic approach, especially in the Russian tradition, we can consider it as an international «commodity» market (i.e. an international gas market, or international financial services market). However, prominent periodicals (for instance, *The Economist*) and research by consultants increasingly tend to use phrasing as «international outsourcing market» to highlight the international trade with goods and services in particular, provided on the basis of outsourcing.

<sup>16</sup> Julia Gravanova, «IT Outsourcing in EMEA: Trends, Practice, Forecasts,» CNews Analytics, 2006, [www.cnews.ru](http://www.cnews.ru).

<sup>17</sup> «Outsourcing: Time to Bring It Back Home,» *The Economist* (5 March 2005).

ing providers, such as German Siemens and the French Group Capgemini, have recorded more prominent results.<sup>18</sup>

Taking the example of the IT international outsourcing market, three waves of countries providing this kind of service can be specified. The «First leading wave» is represented by India. The roots of India's competitiveness in IT reach back to the late 1980s, when American firms such as Texas Instruments and Motorola came to Bangalore for local talent. Other American firms, such as Hewlett-Packard, American Express, Citibank and Dun & Bradstreet followed these pioneers, setting up their own «captive» Indian IT organizations in the 1990.<sup>19</sup> Indian companies got their first large encouragement with the so-called «Y2K crisis» at the turn of the millennium.

In recent years Ireland, Israel, Canada, China, Eastern European countries, Mexico, Russia and Philippines are growing stronger as international outsourcing providers as these countries are witnessing a significant rise in the manufacturing and IT industries.

The «third wave» encompasses Bangladesh, Vietnam, Korea, Cuba, Malaysia, Nepal, Senegal, Sri Lanka, which also have potential opportunities in the field of international IT outsourcing.

The Table 3 below summarizes the areas of focus, main advantages and threats vital for core international outsourcing countries-providers (with main focus on IT and BPO).

*Table 3*

**International outsourcing providers: Strengths and weaknesses  
of major countries/regions**

Country / re- gion	Areas of focus	Strengths / Opportunities	Weaknesses / Threats
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<sup>18</sup> B. Anikin and I. Rudaya, *Outsourcing and Outstaffing: High Technologies of Management* (Moscow: Infra-M, 2006).

<sup>19</sup> «A world of work,» *The Economist* (13 November 2004).



Country / region	Areas of focus	Strengths / Opportunities	Weaknesses / Threats
India	IT services, BPO wide spectrum: call centres, R&D work, financial services (20-25% of staff of big multinationals in financial services is expected to be placed in India in a few years) <sup>20</sup>	Acknowledged leader in IT international outsourcing, more than 10 years experience in this field; English language; highly qualified personnel; enormous labour pool; highly effective body NASSCOM  In 2004, India accounted for about 80% of the low-cost offshore market, and was exerting a stronger pull than ever. <sup>21</sup>	High telecommunication costs; infrastructure sometimes unreliable (airports, hotels, roads, schools and power supply); data security challenge; Indian firms also face competition from specialist American call-centre companies which have been adjusting to the cheap Indian competition by taking themselves to India (America's Convergys)  In the long run, India is sure to face more intense competition, especially from Chinese and Russian side.
China	Hardware design; embedded software; call centers and back-office operations for companies from Japan and Republic of Korea are growing in coastal cities; manufacturing-related R&D work (GE, Siemens and Nokia all do research there)	Low costs	Insufficient (but quickly improving) English language skills; Concerns can arise with regard to the implementation of intellectual property rights.
Philippines	IT, accounting, architecture, telemarketing, Call centres	Good fibre-optic infrastructure in nine IT parks. Good supply of English-speaking, college educated accountants, software engineers, architects, telemarketers and graphic artists. Above-average understanding of the US market	Lack of experience on international outsourcing market
Mexico	IT and engineering.	Good supply of IT experts and engineers; proximity to the US; advantage of Spanish, a vital language for many US businesses	Lack of experience on international outsourcing market
Costa Rica	Call centers targeting Spanish-speaking consumers in the USA and in Europe.	Command of the Spanish language.	Narrow specialization
South Africa	Call centers in French and English, payroll administration	Command of the French and English languages; European time zone compatibility; British and	Modest pool of qualified people; With plenty of established competitors, the necessity to market itself as an offshoring centre;

<sup>20</sup> «The Bangalore Paradox», *The Economist Special Report: Outsourcing and IT in India* (25 April 2005).

<sup>21</sup> «The Bangalore Paradox», *The Economist Special Report: Outsourcing and IT in India* (25 April 2005).

Country / region	Areas of focus	Strengths / Opportunities	Weaknesses / Threats
		American firms could cut cost of some services by 30–40 % by providing them from SA <sup>22</sup>	South African Contact Centre community (SACCOM), lacks the resources to drive the development of the sector (in sharp contrast to India's NASSCOM); Staggering price of telecoms
Eastern Europe (Hungary, Poland, Czech Republic, Romania) <sup>23</sup>	IT services, production, research and business processes	Cultural and linguistic similarities with western Europe; greater ease of ensuring compliance with European regulations; high levels of technical ability; Finely tailored products/ services, that are delivered quickly and flexibly	Corruption can be an obstacle in some countries; steadily rising costs; shortage of customer focused and quality conscious managers (planned economy vestige)
Russian Federation	Complex IT services; R&D centers.	Enormous untapped pool of master's degrees and doctorates in sciences, IT and mathematics	Corruption can be an obstacle; weak infrastructure

Sources: Adopted from «Business Process Offshore Outsourcing: Untapped Opportunities for SMEs,» UNCTAD Paper, 2005; «A world of work,» *The Economist* (13 November 2004); Aaditya Mattoo and Sacha Wunsch-Vincent, «Pre-Emptying Protectionism in Services: The WTO and Outsourcing,» *Journal of International Economic Law* 7:4 (December 2004); *The Economist*, various issues, 2004-2006. The table shows examples and does not represent an exhaustive list.

Taking into consideration the role of international outsourcing and current trends in the world trade system, it might be interesting to study **Russia** and **China** more thoroughly as **outsourcing providers** in this market.<sup>24</sup>

China's ambitions in the international outsourcing market are to become a global power in software and services in order to match its pre-eminence in manufacturing outsourcing. In the meantime Russia aspires to realize its potential in intellectual human capital and to benefit from its advantages in education.

China's areas of focus in the international outsourcing market include manufacturing-related Research and Development work, as well as an increasing share of low-level BPO tasks (such as data entry, form processing and software testing), and more sophisticated services. Russia tends to concentrate on R&D outsourcing. Russian experts are certain that the country will achieve leadership in international R&D outsourcing market, with a turnover of USD thirty billion just for the US.<sup>25</sup> Further Russian areas of focus are represented by engineering outsourcing and provision of information services.

<sup>22</sup> «Can South Africa Ride the Outsourcing and Offshoring Wave?» *The Economist* (27 August 2005).

<sup>23</sup> International outsourcing to Eastern Europe gave birth to the notion of «nearshoring» — the business of moving production, research and business processes to countries that are quite cheap and very close, rather than very cheap and far away.

<sup>24</sup> The information presented below can be also found in Appendix, summarized in Table 4.

<sup>25</sup> Roman Dorokhov, «Science becomes more expensive,» *Vedomosti* (6 February 2006), <http://www.vedomosti.ru/newspaper/article.shtml?2006/02/06/102509>.

For instance, media monitoring and competitors business activity monitoring can be viewed as areas of high potential for Russia.

One more characteristic by which Russian and Chinese positions could be assessed is the market volume of international outsourcing. China's international offshore revenue was about USD 600 million in 2005, compared to about USD 17 billion for India.<sup>26</sup> There is an opinion that the Chinese offshoring market will expand, «particularly as the nation hosts the 2008 Olympics and sees a boost in IT spending by the Chinese government.»<sup>27</sup> According to various surveys, total world expenditure by companies on outsourcing are to reach USD 1 trillion. Russia accounts now for USD 350 million. Taking into account advanced outsourcing market growth rates in Russia, compared with world ones (80% annually), in 2008 it is possible to reach USD 4 billion.<sup>28</sup> By Gartner estimations, by 2007 Russia will account for five per cent of the international outsourcing market.

It is also possible to trace the main centers for international outsourcing in Russia and China. Xian is home to one of China's largest technology parks — a 35-square-kilometre Chinese Silicon valley housing 7500 companies and supported by more than 100 universities. The Xian High-Tech Industries Development Zone is expected to span eventually 90 square kilometers.<sup>29</sup> Chengdu, Wuhan are also considered as places for location by foreign firms. Russian centers for outsourcing are so far more modest, with only technology parks and special zones. IT outsourcing activities are concentrated in Moscow, St. Petersburg and Novosibirsk, and show 40-60% growth a year.<sup>30</sup> Fortune 500 companies are also opening centers in Russia, with Motorola, Intel, Sun, IBM, Boeing, Dell and Nortel just a few of the companies that have established large development centers in places such as Moscow and St. Petersburg.

China's critical strengths in the international outsourcing market include staff discipline and lack of creativity. Disciplined and readily trained staff show themselves better at tedious jobs than in India. At the same time, the lack of creativity could be considered as an advantage whereby BPO encompasses plenty of repetitive, rules-based tasks that do not require innovation. Likewise, Russia's strengths lie in a strong education system that results in the availability of a large and skillful workforce on the IT market; an array of specialized expertise capable of solving large-scale, complex technical problems; and advantage in the cost of labor over US and Western European countries; cultural and geographic proximity to Western Europe and the US.

<sup>26</sup> Ian Lamont, «China's offshoring ambitions», [www.computerworld.com](http://www.computerworld.com) (15 August 2005).

<sup>27</sup> Ian Lamont, «Problems finding, keeping Chinese IT workers», [www.computerworld.com](http://www.computerworld.com) (26 June 2006).

<sup>28</sup> «IT Economics and law», <http://www.cnews.ru> (11 April 2006).

<sup>29</sup> «Watch out, India», *The Economist Special Report: Outsourcing to China* (6 May 2006).

<sup>30</sup> Stewart Clements and Michael Donnellan, *CFO Insights: Achieving High Performance Through Finance Business Process Outsourcing* (Moscow: Publisher «Verzhina», 2006), 194.

However, there is a range of disadvantages which might hinder the demand for outsourcing from these countries. In China's case these include an educational system that emphasizes theory over practice; high IT staff turnover; insufficient English language skills; and, rampant fears about piracy of intellectual property. Russia's main disadvantage is the lack of excellent management skills and quality in services, whereas the lack of intellectual property protection also constrains growth.

Future opportunities for China in international outsourcing lie in competitive advantages over India, namely in:

- Price advantage (on the current stage), especially as India's prices are climbing and India is becoming too expensive to outsource there;
- A superior infrastructure to India's and tax breaks; and
- Strong support by the state in contrast to that in India.

In addition, China could benefit from the desire of MNCs to diminish risks associated with India. Accordingly, IBM, Hewlett-Packard, Microsoft, Siemens and others have been in China for several years and are adding staff.

Moreover, China's outsourcing providers could find clients among Japanese NEC, Fujitsu and South Korean companies. Xian's annual outsourcing revenues are USD 40 million, according to official figures, with over 90% of that coming from Japan.<sup>31</sup>

As one of the recent trends, even Indian firms specializing in outsourcing are discovering China. For example, Indian Infosys and Wipro are located in Shanghai and Beijing and plan to increase their workforces from a few hundred to 5000-6000 over the next few years.<sup>32</sup>

As for Russian opportunities, these are closely tied with the National Association of Software Engineers to drive growth. Furthermore, R&D are becoming increasingly important and are hardly affordable for single companies. According to Deloitte, analytics, in close future cooperation with R&D, will increase and new technologies increasingly will be created on the basis of international outsourcing (in India, China, Russia and Eastern Europe).

As such challenges are overcome, Russia's forthcoming accession to the WTO also could result in eliminating disadvantages (especially in perfecting legislation in intellectual property rights) and in opening new opportunities.

Both Russian and Chinese outsourcing markets are currently under certain threats and face challenges that need to be overcome. One of the critical threats to China is the low number of qualified graduates. In addition, local politicians are hindering the consolidation of China's outsourced-service sector, sometimes blocking mergers with firms outside their regions in fear of losing influence; this contrasts with India's national trade agency, Nasscom, which encourages developments such as consolidation that help the industry.

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<sup>31</sup> «Watch out, India», *The Economist Special Report: Outsourcing to China* (6 May 2006).

<sup>32</sup> Infosys data (<http://www.infosys.com>) and Wipro data (<http://www.wipro.com>).

In Russia's case, after accession to the WTO its interests in the intellectual services field may conflict with those of its foreign partners. Russia will either have to learn to follow common rules, or to leave the market. Moreover, Russia must solve the problem inherited from the Soviet period of a time gap between an invention, its development and commercial exploitation in order to occupy a strong place in the international outsourcing market.

As a leading provider of IT and BPO services that are outsourced internationally, India is expected to face competition, especially from China and Russia.<sup>33</sup> The expansion of outsourced service consumers outside India is being driven by increasing demand, a desire for lower costs, more even distribution of risks and local support for their growing global operations.

In the meantime, as per the inevitable principles of international economic relations,<sup>34</sup> core international outsourcing market participants are willing to benefit from a division of and specialization. The evidence suggests that at the moment China is likely to capture an increasing share of low-level BPO tasks (such as data entry, form processing and software testing), while India continues to dominate in higher-value functions, such as research and design, which require greater creativity and language skills. In the current context Russia has an opportunity to gain and sustain a strong place in the international research and development and engineering outsourcing markets.

An additional closely related trend is the cooperation at the firm or even company levels taking place in the international outsourcing market. One recent example of this is the deal between TCS, an Indian outsourcing giant, the Chinese government and Microsoft to build China's first large software company to provide IT services for the Olympics.<sup>35</sup>

## 2. Main Challenges of International Outsourcing

To sum up the abundant media publications on international outsourcing, its consequences could be presented in a very schematic way as cost reduction benefits combined with job loss expectations for the outsourcing countries (predominantly developed countries), and prospects for growth and job creation for countries — outsourcers (primarily emerging markets), with opportunities for core businesses to concentrate and market players to specialize in both groups of countries<sup>7</sup>.

<sup>33</sup> Stewart Clements and Michael Donnellan, *CFO Insights: Achieving High Performance Through Finance Business Process Outsourcing* (Moscow: Publisher «Vershina», 2006).

<sup>34</sup> Here we mean the «comparative advantages» theory by David Ricardo and Adam Smith, whose methodology has been further expounded, evolved in various ways, and is nowadays implemented by some economists in analyzing international outsourcing. Paul A. Samuelson, «Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization,» *Journal of Economic Perspectives* 18:3 (2004).

<sup>35</sup> «Watch out, India», *The Economist Special Report: Outsourcing to China* (6 May 2006).

In the meantime, sourcing from low-cost countries brings diverse economic benefits. Cheaper labour reduces production costs. This keeps companies competitive, raises profits and reduces prices as firms pass their lower costs onto their customers. Higher profits and lower prices raise demand and keep inflation in check. Companies spend their profits on improving existing products or introducing new ones. Customers buy more of the things they already consume, or spend money on new goods and services.

Relocating work abroad may also help to speed up innovation directly, as American, European and Japanese companies have some of their R&D done by Chinese, Russian or Indian engineers<sup>36</sup>.

Moreover, by making IT more affordable, sourcing from cheaper countries also spreads the productivity-enhancing effects of such technology more widely through the economy. For instance, Ms Mann (2004) of the Institute for International Economics calculates that globalised production and international trade has made IT hardware 10-30% cheaper than it would otherwise have been. She asserts that this price reduction created a cumulative US\$230 billion-worth of additional GDP in the US between 1995 and 2002 as the more widespread adoption of IT raised growth in productivity. Sourcing IT services (which account for about 70% of overall corporate spending on IT) from countries such as India will create a «second wave of productivity growth», predicts Ms Mann, as cheaper IT spreads to parts of the economy that have so far bought less of it, such as the health-care industry and smaller companies.<sup>37</sup>

In addition, in the longer run aging populations in rich countries will mean labour shortages in many industries; thus, sourcing some of the work from abroad might ease the problem. It would also help to increase the productivity of rich-country workers who would have to support larger numbers of older people. Furthermore, outsourcing could help to lower some of the costs of an aging population, especially in health care. Farming out the sizeable job of administering a health-care system to lower-cost countries would reduce costs in such areas.

However, there are some constraints on international outsourcing growth and potential threats for engaged participants that are the subject of concern and inspire efforts to overcome them. These constraints and threats are linked with potential opportunities for international outsourcing for these market players.

First, the controversy about outsourcing concerns the increasing scope and significance of the international outsourcing of services. As yet a common position does not exist in academic circles on whether trade in services should

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<sup>36</sup> «A World of Work: Special Report on Outsourcing.» *The Economist* (13 November 2004).

<sup>37</sup> «Sink or Schwinn», *The Economist* (13 November 2004).

be treated with the same analytical tools as trade in goods, or whether it presents different issues.<sup>38</sup>

However, there are more practical challenges posed by international outsourcing for the international trade system. These include combinations of threats and constraint of potential or hidden opportunities and range from influence on technical progress to consequences for employment in those countries from which jobs have been outsourced. Surprisingly there are very few challenges originating in the countries where the jobs have been relocated. Both these groups of challenges are discussed in more detail below.

Since services account for between two-thirds and three-quarters of total employment in developed economies,<sup>39</sup> productivity gains in this sector are essential to economic growth and improvement in welfare. Furthermore, since services constitute a large and growing share of GDP in developed as well as emerging economies, world trade growth would probably slow down relative to world income growth in the long run if services were not traded. «World trade has been an important engine of world growth and development during the post-World War II period and trade in services, and including offshoring, will sustain this process. In short, offshoring contributes to a continuation of the post-World War II trend of increased international integration, where trade as a share of GDP has increased and led to growth (for all participants) through specialization, technology diffusion and shifting comparative advantage».<sup>40</sup>

Constant improvements in technology and global communications suggest that the future will bring much more offshoring of «impersonal services» — that is, services that can be delivered electronically over long distances with little or no degradation in quality. However, limits to the growth of international outsourcing are already appearing. Technology, which made it possible to shift such work abroad initially, is now helping to bring it back. Banks, for instance, are starting to use automated call centres. In Great Britain, Lloyds/TSB, Halifax and Egg are all using a system provided by Adepta, which allows them to call customers and make anti-fraud checks on credit-card transactions without the use of a human voice. Such operations are firmly based in the bank's home country.<sup>41</sup>

In 2004 the outsourcing of services received a large amount of attention in the media and political circles, largely because many reports equated international outsourcing with job losses. (Amity, Wei, 2004). Studies on service outsourcing and employment effects mainly have been conducted by management consultants. For example, Gartner predicted that, as a result of global outsourcing trends, up to 25 per cent of traditional IT jobs in

<sup>38</sup> Paul A. Samuelson, «Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization», *Journal of Economic Perspectives* 18:3 (2004).

<sup>39</sup> *World Trade Report 2005* (Geneva: UNCTAD, 2005) www.unctad.org.

<sup>40</sup> *World Trade Report 2005* (Geneva: UNCTAD, 2005) www.unctad.org.

<sup>41</sup> «Outsourcing: Getting the Measure of It», *The Economist* (2 July 2005).

many developed countries today will be situated in emerging markets by 2010.<sup>42</sup> Similar forecasts and a public backlash provoked researchers to recognise the anxiety about job losses resulting from international outsourcing, to investigate the link international outsourcing and job losses (Amiti, Wei, 2004, IMF; Jensen and Kletzer, 2005) and to provide sound counterarguments (Bhagwati, 2004). To sum up, although international outsourcing is growing rapidly it still «remains a small fraction of industrial countries' GDP».<sup>43</sup> The IMF shows that net jobs are not being exported from industrial countries to developing ones as a result of outsourcing. In fact the evidence suggests that jobs losses in one industry often are offset by jobs created in other growth industries.<sup>44</sup> Moreover, the same changes in production technology that destroy jobs also create new ones. Due to machines and foreign workers which can perform the same work more cheaply, the cost of production falls. That means higher profits and lower prices, lifting demand for new goods and services. Entrepreneurs set up new businesses to meet the demand for these new necessities of life, thereby creating new jobs. As Alan Greenspan, chairman of the US Federal Reserve Bank, pointed out, «there is always likely to be anxiety about the jobs of the future, because in the long run most of them will involve producing goods and services that have not yet been invented.»<sup>45</sup> For instance, William Nordhaus, an economist at Yale University, calculated that «under 30 % of the goods and services consumed at the end of the twentieth century were variants of the goods and services produced 100 years earlier».<sup>46</sup>

At the firm level there are technical, strategic and managerial limits to offshoring. Technical limits relate to the extent to which services are separable from the core activities of a firm. Strategic limits relate to the need of a company to control strategic assets, while managerial limits relate to managerial capability and costs of dealing with foreign suppliers.

According to the McKinsey Global Institute, if current demand continues, the supply of suitable labour in cities such as Prague and Hyderabad will run short by the end 2006—2008. The demand for engineers from Britain and America alone will use up the suitable supply in all of China, India and the Philippines by 2011. Therefore, the Institute advises firms to choose their locations carefully to avoid further possible difficulties with relocation and having to shift their activities and assets.<sup>47</sup>

Besides that, we should highlight an increasing concern about data security. For instance, in India after some fraud scandals, NASSCOM's represen-

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<sup>42</sup> Gartner Research materials, <http://www.gartner.com>.

<sup>43</sup> Mary Amiti and Shang-Jin Wei, «Demystifying Outsourcing», *Finance & Development* (December 2004).

<sup>44</sup> International Monetary Fund, [www.imf.org](http://www.imf.org).

<sup>45</sup> «A World of Work: Special Report on Outsourcing», *The Economist* (13 November 2004).

<sup>46</sup> «A World of Work: Special Report on Outsourcing», *The Economist* (13 November 2004).

<sup>47</sup> «Offshoring: Is It a WinWin Game?» McKinsey Global Institute, San Francisco: McKinsey, 2003.



tatives campaigned for standards to be raised higher than those prevailing in Britain and America, in order to make data protection a selling-point for India.

Among more specific challenges, British and American companies already will have developed much stronger ties with India and other such countries, and costs will have risen. This will hurt especially Europe's big financial firms given that the largest banks spend billions of dollars a year on IT. Experts speculate that some European financial firms could be so badly damaged by this loss of competitiveness that they may fall into the arms of healthier American and British rivals.<sup>48</sup>

In sum, thus far we have seen barely the tip of the international outsourcing iceberg, the eventual dimensions of which may be controversial and provide ground for further investigation.

Nevertheless, the threat of international outsourcing should not be exaggerated. According to Alan Blinder (2006), just as the first Industrial Revolution did not banish agriculture from the rich countries, and the second Industrial Revolution has not banished manufacturing, so the third Industrial Revolution will not drive all impersonal services offshore. «Nor will it lead to mass unemployment. But the necessary adjustments will put strains on the societies of the rich countries, which seem completely unprepared for the coming industrial transformation».<sup>49</sup>

One more extremely important sort of challenges implied by international outsourcing deals with its regulation.

The growing volume and scope of exportable services and the possibility of explicit and implicit protectionism towards outsourcing call for determined and innovative regulation in the context of international economic organisations, primarily GATS negotiation strategies.

### 3. International Outsourcing Regulation Issues

#### *International Outsourcing issues in country's foreign economic policy*

With regard to the present scope and dynamics of international outsourcing operations, a firm or a country that strives to be an efficient market participant faces a task, both on the micro and macro levels, to benefit from international specialization (with international outsourcing being its prominent vehicle), smoothing out at the same time its negative effects and overcoming

<sup>48</sup>«A World of Work: Special Report on Outsourcing.» *The Economist* (13 November 2004).

<sup>49</sup>Alan S. Blinder, «Offshoring: The Next Industrial Revolution?» *Foreign Affairs* 85:2 (March/April 2006): p. 113—128.

challenges. Therefore, national regulation is currently no less required than a long-term corporate outsourcing strategy.

Previously India's IT industry has thrived in part because, unlike most sectors of the economy, it largely has kept the government out of its business. Thus, recently India has had to face a rather challenging situation whereby some of the constraints on succeeding further in the international outsourcing market (infrastructure, education, security standards) can be solved only by government.

The offshoring sector is considered a priority by the government in South Africa. A public-private partnership is being set to develop this sector.

Its weak competitiveness in the international service market is recognized to be one of the current problems for the Russian economy. Indeed, one of the country's challenges is to increase its participation in one of the most dynamic and promising areas of international trade, i.e. cross border trade in services, especially in intellectual services. In this respect, Russia's future place as a player in the global market depends on the long-term regulation of international outsourcing and on the country's involvement in international-level regulation. According to the Ministry of Trade and Development of the Russian Federation (Department for Trade Negotiations), during the negotiations on WTO accession the outsourcing issues were not addressed directly. Nevertheless, when Russia becomes a WTO member, it will receive access to tools that will shape future negotiation strategies concerning outsourcing which will appear on the agenda.

#### ***Contribution of International Economic Organizations Into Offshoring Regulation***

As cross-border trade in services grows, with already both emerged and emerging markets among the most dynamic exporters, international economic organizations and the WTO in particular have increased their attention on the phenomenon.

The language of the WTO, under its General Agreement on Trade in Services (GATS), categorizes four different ways in which services can be traded:

In Mode 1 of WTO terminology, trade in services involves arm's-length supply of services, with the supplier and buyer remaining in their respective locations. Both individuals and firms can provide Mode 1 services, whereby individuals are independent designers, architects and consultants who sell their services electronically to manufacturers and consumers around the world. In the case of firms, these include large firms that manage call centers, back offices and software programmers.

Mode 2 services are provided by moving the service recipient to the location of the service provider. In Mode 3, the service provider establishes a commercial presence in another country, requiring an element of foreign di-

rect investment. The most prominent examples of Mode 3 services are banking and insurance. In Mode 4, the service seller moves to the location of the service buyer. Construction and consulting, medical and educational services are often provided through this mode.<sup>50</sup>

Trade in Mode 1 services is what most economists mean when they discuss «international outsourcing.»<sup>51</sup>

As emphasized by detailed World Bank research on the topic, despite the substantial benefits from cross-border trade, it is possible that the adjustment pressures created in importing countries could provoke a protectionist backlash — some signs of which are already visible in regulatory restrictions.<sup>52</sup> For example, legislative action has already been initiated in the US to create a trade barrier for BPO services: New Jersey State Senator Turner tabled a bill in September 2002 aimed at preventing the outsourcing of public work to Mumbai.<sup>53</sup> In Australia there were news reports of lobbies by Australian software companies to restrict the ability of other Australian firms<sup>7</sup> to outsource software designs to India. In the US, the Senate passed restrictions on foreign outsourcing for federal contracts in March 2004 (though it has yet to become law).<sup>54</sup>

The current negotiations under the Doha Round offer an opportunity to use protectionism as a defensive tool. This is best accomplished not by perpetuating the WTO's decision on duty free electronic commerce, but by comprehensive commitments on cross-border trade in services under the GATS. Full commitments on market access and national treatment would preclude, respectively, all quantitative restrictions and all forms of discrimination against foreign providers.

World Bank paper reveals at least two weaknesses of the GATS system which may impair the liberalization of international outsourcing-related services:

Firstly, in the current GATS framework, the market access commitments of each WTO Member apply only to the sectors it chooses to list. So if a service is not explicitly listed then a Member remains free to restrict on trade in that service. This «positive listing» approach places a heavy burden on the services classification scheme used by Members. The existing classification scheme does not cover all the services being traded today, such as the services offered by call centers. Revising the classification does not offer a durable solution because no classification scheme can

<sup>50</sup> World Trade Organization, [www.wto.org](http://www.wto.org).

<sup>51</sup> Jagdish Bhagwati, Arvind Panagariya and T. N. Srinivasan, «The Muddles Over Outsourcing», *Journal of Economic Perspectives* 18 (Fall 2004).

<sup>52</sup> Aaditya Mattoo and Sacha Wunsch-Vincent, «Pre-empting Protectionism in Services: The WTO and Outsourcing.» World Bank Policy Research Working Paper 3237, 2004, March, Washington, United States, <http://ideas.repec.org/p/wbk/wbrwps/3237.html>.

<sup>53</sup> «U.S. States May Ban Contract Outsourcing», *Financial Times* (21 February 2003).

<sup>54</sup> Mary Amiti and Shang-Jin Wei, «Service Offshoring, Productivity, and Employment: Evidence from the United States.» IMF Working Paper WP/05/238 (2005).

keep up with changes in technology, business practices and skills, and anticipate the ever-widening range of new services that will be traded.

Secondly, WTO Members traditionally negotiate access in services through the «request-and-offer» approach which involves negotiating commitments trading partner by trading partner, sector by sector. This is a painful task with high costs in terms of negotiating resources, it does not necessarily produce efficient or equitable outcomes in a world of unequal bargaining power, and offers no credible way of granting credit to the unilateral liberalizers. Not surprisingly, past services negotiations showed a meager result in liberalizing commitments.<sup>55</sup>

It is evident that more innovative approaches are necessary, and the growing volume and scope of exportable services and the possibility of explicit and implicit protectionism towards outsourcing call for determined GATS negotiation strategies.

Mattoo and Wunsch (2004), who thus far provided one of the deepest and most thought provoking investigations on international outsourcing regulation, suggest the following ways for extending opportunities for trade involving outsourcing under WTO:

The first option is for WTO Members to make liberalizing commitments on the basis of a model schedule designed to cover the information technology and business process outsourcing (BPO) services that are at the heart of the current trade boom. An essential step is to map the IT and BPO services being traded today into the existing GATS classification scheme, a task this note undertakes.

Further possibility implies, that both the classification and negotiating problem may be addressed through an innovative proposal requiring that all (or a critical mass of) WTO Members commit not to impose any restrictions on cross-border trade in any except a mutually agreed (narrow) set of services. Such a proposal would combine two elements: a negative list approach for cross-border trade that finesses the whole classification issue by treating all services as covered except the explicitly excluded few; and a «formula» approach that avoids the difficulty of the request-and-offer approach by requiring all WTO Members (or a critical mass) to undertake the specified level of commitments.<sup>56</sup>

### ***Prospects for Regulating International Outsourcing Within International Economic Organizations***

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<sup>55</sup> Aaditya Mattoo and Sacha Wunsch-Vincent, «Pre-empting Protectionism in Services: The WTO and Outsourcing,» World Bank Policy Research Working Paper 3237, 2004, March, Washington, United States, <http://ideas.repec.org/p/wbk/wbrwps/3237.html>.

<sup>56</sup> Aaditya Mattoo and Sacha Wunsch-Vincent, «Pre-empting Protectionism in Services: The WTO and Outsourcing,» World Bank Policy Research Working Paper 3237, 2004, March, Washington, United States, <http://ideas.repec.org/p/wbk/wbrwps/3237.html>.

Taking into account the international outsourcing market's constant evolution, we will soon need to view how far other complex trade issues that arise in this respect (e.g., the issue of applicable jurisdiction, data privacy issues, etc.) can be addressed in the WTO and in what way other organizations may contribute to regulating outsourcing. As outlined by Mattoo and Wunsch (2004), «much of the deeper integration of regulations that is needed to support the development of international outsourcing, and especially cross-border trade in services, is already taking place in other contexts»<sup>57</sup>. For example, the OECD is addressing issues of tax treatment, the WIPO is considering several issues related to the protection of intellectual property rights (that are critical today due to leading outsourcers facing security challenges and the necessity of global standards implementation) and the Council of Europe is reviewing certain aspects of cyber crime. The challenge is, according to World Bank experts, to «ensure that the regulatory cooperation in these fora is not exclusionary and leading to regulatory trade diversion but inclusive and encouraging the enhanced participation of developing countries».<sup>58</sup>

### Conclusion

A wide range of benefits gained from offshoring by buyers of outsourced goods and services drive the growing demand, especially for IT and BPO services. The worldwide market for offshore spending on IT services for predominantly Western companies is expected by Gartner to reach USD 50 billion by 2007 and to increase even more. The market for BPO, ranging from processing bills and credit-card applications to managing entire human resources operations, should be worth another USD 24 billion by 2007, and is expanding even faster.<sup>59</sup> This situation suggests various opportunities for sellers in the international outsourcing market: first of all, for former leaders such as India (who might go up-value and become more specialised in more sophisticated outsourced service complexes), and also for new players who might find their niche in this market (China and Russia, Eastern Europe, South Africa,).

There is every reason to believe that the comparative advantage of developing countries will not be limited to standard back office services. Already, cross-border service exports have evolved from lower-end, disentangled BPO services to more integrated, expert-based and web-enabled services. Companies have started to move up the value chain by focusing

<sup>57</sup> Aaditya Mattoo and Sacha Wunsch-Vincent, «Pre-Emptying Protectionism in Services: The WTO and Outsourcing,» *Journal of International Economic Law* 7:4 (December 2004).

<sup>58</sup> Aaditya Mattoo and Sacha Wunsch-Vincent, «Pre-empting Protectionism in Services: The WTO and Outsourcing,» World Bank Policy Research Working Paper 3237, 2004, March, Washington, United States, <http://ideas.repec.org/p/wbk/wbrwps/3237.html>.

<sup>59</sup> «Can South Africa Ride the Outsourcing and Offshoring Wave?» *The Economist* (27 August 2005).

on innovation, consulting, branding and increasingly integrated services. In addition, more sophisticated cross-border trade activities like «Training/Online Education», «Product Design and Development Services» and «Technical Testing» are already being exported. Further changes in technology, the developing country skills set and business practices are bound to lead to cross-border trade in ever more sophisticated services.<sup>60</sup>

As our world becomes more dependent on technology, and the role of the services sector increases in terms of impacting on the larger environment, a country needs to become a global power in IT and services in order to gain and keep a strong position on the global arena. Attracting outsourced business is essential in this respect, for emerging markets in particular.

As a reflection of globalisation and an increasingly important phenomenon, international outsourcing needs to be regulated both on the national (as already understood by most governments and business circles of countries' engaged in offshoring) and international levels. Existing regulation tools do not correspond with current trends; therefore, we need to elaborate on new innovative regulation programmes, and in the process create an environment for further stable international outsourcing development.

The current scope and dynamics of international outsourcing suggest that regulation of this field of international economic relations will be top of the agenda of both the national level and in international economic organisations.

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Appendix

Table 4

**China and Russia as international outsourcing providers**

China	Russia
Ambitions on international outsourcing market	
To become a global power in software and service to match its pre-eminence in manufacturing outsourcing	To realize intellectual potential of human capital, and to benefit from advantages in education
Areas of focus	
<p>Manufacturing-related Research and Development work;</p> <p>Primarily, an increasing share of low-level BPO tasks (such as data entry, form processing and software testing); working towards prospects in more sophisticated services</p>	<p>Research and Development outsourcing (Russian experts are certain that Russia will become a leader in the international R&amp;D outsourcing market, with a turnover of USD 30 billion just for the US<sup>61</sup>);</p> <p>Engineering outsourcing;</p> <p>Information services provision, for instance media monitoring and competitors business activity monitoring, can be viewed as a high potential for Russia</p>
Market volume	
China's international offshore revenue was about usd 600 million in 2005, compared to about usd 17 billion for India. <sup>62</sup> There is an opinion that the Chinese offshoring market will expand, «particularly as the nation hosts the 2008 Olympics and sees a boost in IT spending by the Chinese government.» <sup>63</sup>	<p>According to various surveys, total world companies expenditure on outsourcing are to reach usd1 trillion. Russia accounts now for usd 350 million. Taking into account, advanced outsourcing market growth rates in Russia, as compared with world ones (80% annually), in 2008 it is possible for this to increase to 4 billion.<sup>64</sup></p> <p>By Gartner estimations, by 2007 Russia will account for 5% of international outsourcing market.</p>
Main centers	

<sup>61</sup> *Dorokhov Roman*. Science becomes more expensive. // *Vedomosti*, 2006, February 6<sup>th</sup>, <http://www.vedomosti.ru/newspaper/article.shtml?2006/02/06/102509>.

<sup>62</sup> *Ian Lamont*. China's offshoring ambitions// [www.computerworld.com](http://www.computerworld.com) 2005, August, 15<sup>th</sup>.

<sup>63</sup> *Ian Lamont*. Problems finding, keeping Chinese IT workers // [www.computerworld.com](http://www.computerworld.com) 2006, June, 26<sup>th</sup>.

<sup>64</sup> *IT Economics and law*, 2006, April 11<sup>th</sup>.

China	Russia
<p>Xian is home to one of China's biggest technology parks — a 35-square-kilometre Chinese Silicon valley housing 7500 companies and supported by more than 100 universities. The Xian High-Tech Industries Development Zone is expected to span eventually 90 square kilometers.<sup>65</sup></p> <p>Chengdu, Wuhan are also considered as places for location by foreign firms</p>	<p>Russian centers for outsourcing are so far more modest, with technology parks and special zones only arising.</p> <p>IT outsourcing activities are concentrated in Moscow, St. Petersburg and Novosibirsk, and shows 40-60% growth a year.<sup>66</sup></p> <p>Fortune 500 companies opening centers in Russia, Motorola, Intel, Sun, IBM, Boeing, Dell and Nortel are just a few of the companies that have established large development centers in places such as Moscow and St. Petersburg.</p>
<b>Critical strengths</b>	
<ul style="list-style-type: none"> <li>• Disciplined and readily trained staff, showing themselves better at tedious jobs, than most of Indians are.</li> <li>• Lack of creativity could be considered as benefit here, as BPO encompasses plenty of repetitive, rules-based tasks that do not require innovation.</li> </ul>	<ul style="list-style-type: none"> <li>• Strong education system that results in the availability of a large and skillful workforce on the IT market.</li> <li>• Array of specialized expertise capable of solving large-scale, complex technical problems</li> <li>• Cost of labor advantage over the US and Western European countries</li> <li>• Cultural and geographic proximity to Western Europe and the US</li> </ul>
<b>Disadvantages that might hinder the demand for outsourcing from these countries</b>	
<ul style="list-style-type: none"> <li>• An educational system that emphasizes theory over practice</li> <li>• High IT staff turnover</li> <li>• Insufficient English language skills.</li> <li>• Rampant fears about piracy of intellectual property</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of excellent management skills and services quality</li> <li>• Lack of intellectual property protection also constrains growth</li> </ul>
<b>Opportunities</b>	
<ul style="list-style-type: none"> <li>• Opportunities for China lie in competitive</li> </ul>	<ul style="list-style-type: none"> <li>• Association of Software engineers to drive</li> </ul>

<sup>65</sup> Watch out, India. // The Economist special report: Outsourcing to China, 2006, May 6th .

<sup>66</sup> Clements Stewart, Michael Donnellan, «CFO Insights: achieving High Performance Through Finance business Process Outsourcing», Moscow, 2006. P. 194.

China	Russia
<p>advantages over India:</p> <ul style="list-style-type: none"> <li>— Price advantage (on current stage), especially as India's prices are climbing and India is becoming too expensive to outsource there</li> <li>— Infrastructure superior than India's, tax breaks</li> <li>— Strong support by state in contrast to India</li> <li>• The desire of MNCs to spread risks away from India. That explains why IBM, Hewlett-Packard, Microsoft, Siemens and others have been in China for several years and are adding staff.</li> <li>• Japanese NEC, Fujitsu and South Korean clients of Chinese outsourcing providers (Xian's annual outsourcing revenues are USD 40 millions, according to official figures; over 90% of that comes from Japan<sup>67</sup>).</li> <li>• As one of the recent trends, China is being discovered by the very Indian firms, specializing on outsourcing. For example, Indian Infosys and Wipro are located in Shanghai and Beijing and plan to increase their workforces from a few hundred to 5000-6000 each over the next few years.<sup>68</sup></li> </ul>	<p>growth</p> <ul style="list-style-type: none"> <li>• Research and Development tend to become increasingly important and are hardly affordable for single companies. According to Deloitte analytics, in close future cooperation in R&amp;D will boost, and new technologies will be increasingly more created on international outsourcing basis (in India, China, Russia and Eastern Europe)</li> <li>• Despite the accomplished challenges, Russia's forthcoming accession to the WTO could result in eliminating disadvantages (especially the perfection of intellectual property rights legislation) and in capturing new opportunities</li> </ul>
<p>Threats and Challenges</p>	
<ul style="list-style-type: none"> <li>• Weak qualification of graduates</li> <li>• Local politicians hinder consolidation in Chinese outsourced-service sector, sometimes blocking mergers with firms outside their regions, if they risk losing influence (In contrast with Indian national trade body Nasscom, that encourages developments such as consolidation that look likely to help the industry.)</li> </ul>	<ul style="list-style-type: none"> <li>• After the WTO accession Russian interests in intellectual services field may face with those of its foreign partners. Russia will either have to learn to follow common rules, or to leave the market</li> <li>• Lag from the Soviet period of gaps between an invention, its development and commercial exploitation</li> </ul>

Sources: Compiled from The Economist publications 2005, 2006 and others.

<sup>67</sup> Watch out, India. // The Economist special report: Outsourcing to China, 2006, May 6th  
<sup>68</sup> <http://www.infosys.com>, <http://www.wipro.com>